



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS**

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Date:	Enrolled	Bill No:	Senate Bill 1203 Assembly Bill 1760
Tax Program:	Property	Author:	Jackson Chau and Bocanegra
Sponsor:	BOE Chairman Horton (SB 1203)	Code Section:	RTC (see below)
Position:	Support	Effective Date:	01/01/15

**This analysis is limited to the property tax provisions of these bills.
Both bills must be enacted for either bill to become effective.**

BILL SUMMARY

Related to a property tax exemption for low-income rental housing projects, these double-jointed bills:

- Prohibit local governments from entering into a payment in lieu of taxes (PILOT) agreement with a property owner of a low-income housing project. §214.06
- Create a conclusive presumption that any funds from payments under a PILOT agreement entered into before January 1, 2015 are used to maintain affordability or reduce rents. §214.07
- Related to any property taxes levied (or that might be levied) because a PILOT agreement was deemed to preclude certification that property tax savings are used to maintain affordability or reduce rents:
 - Require cancellation of outstanding tax liabilities. §214.08
 - Require refunds of taxes paid.
 - Prohibit escape or supplemental assessments.
- Related to the provisions that allow a partial exemption on property and related facilities when the rental housing does not exclusively serve low-income residents:
 - Specify that the partial exemption percentage calculation use a unit method. §214(g)(1)
 - Define “related facilities” to explicitly include certain items. §214(g)(3)(B)
 - Define “units serving lower income households” to explicitly address units that are vacant when determining the occupancy percentage. §214(g)(3)(C)

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ANALYSIS

PILOT Agreements

§214.06, §214.07, §214.08, §214.09

CURRENT LAW

PILOT Agreements. Existing property tax law is silent on the issue of PILOT agreements related to low-income rental housing projects.¹

Property Tax Exemption. The law provides that the welfare exemption applies to certain low-income rental housing properties.² One exemption requirement is that the property owner must be able to certify the following:

- That an enforceable and verifiable agreement exists restricting the development to appropriate lower income household usage and rents.
- That the property tax savings from the exemption are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households.³

The question has been raised whether a property owner can properly make the above certification when it has entered into a PILOT agreement with local government. The BOE issued a non-binding [legal opinion](#) that a property owner can make the required certification in good faith if rents actually meet or are lower than the restrictions set forth in the enforceable agreement, and if the property owner has a reasonable belief that its PILOT payment will go directly to support or benefit the low-income household units.

Exemption revocation. The exemption has been revoked and escape assessments issued in at least one county which deemed payments made under a PILOT agreement to disqualify the property owner's certification regarding the use of property tax savings. Other counties are considering this issue.

PROPOSED LAW

PILOT Agreements. On or after January 1, 2015, these bills prohibit a local government from entering into an agreement with the owner of a low-income housing project. Any PILOT agreement entered into in violation of this provision is void and unenforceable. These bills specify that no inference shall be drawn as to whether a local government had the authority to enter into a PILOT agreement prior to January 1, 2015. §214.06

PILOT agreement means any agreement entered into between a local government and a property owner of a low-income housing project to pay the local government a charge to compensate the local government for lost property tax revenues resulting from the property tax exemption available under Section 214(g). §214.09(c)

Conclusive Presumption. These bills create a conclusive presumption that any payments made under any PILOT agreement entered into before January 1, 2015, comply with the required certification that property tax savings were or are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households. §214.07

¹ Revenue and Taxation Code (RTC) [§237\(b\)](#) addresses payments that an Indian tribe may make related to a low-income housing project owned and operated by the tribe.

² RTC §214(g)

³ RTC §214(g)(2)(B)

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Refunds and Cancellations. These bills require any outstanding ad valorem tax, interest, or penalty that was levied between January 1, 2012, and January 1, 2015, as a result of a PILOT agreement to be canceled, and any payments previously paid to be refunded. §214.08(a)(1)

Escape Assessments. On or after January 1, 2015, these bills prohibit any escape assessments from being levied on the basis that payments made under a PILOT agreement were, or are, being used in a manner incompatible with the certification regarding the use of property tax savings.⁴ §214.08(a)(2)

Legislative Declaration. Related to the property tax exemption available to low-income housing projects, Legislative findings and declarations state that:

[I]n enacting subdivision (g) of Section 214 of the Revenue and Taxation Code in 1987, [the Legislature] determined that the funds that were being paid in property taxes could better be used in furtherance of the goal of providing low-income housing and that a property tax exemption was necessary to ensure that low-income housing properties with restricted rents would be able to provide the residents with a livable community and remain financially feasible over the life of the deed restrictions, generally 55 years.

BACKGROUND

Recently the Ventura County Assessor's Office sent notification of possible welfare exemption revocation to five nonprofit housing developments that have PILOTs with various cities. The assessor took this action after the office received a courtesy copy of a December 23, 2011 BOE legal opinion letter (never annotated). The legal opinion concluded that the required RTC Section 214(g)(2)(B) certification could not be made with respect to a certain PILOT agreement calling for in-lieu payments to the local government. Thereafter, the assessor's office investigated other low-income housing projects with PILOTs, and a statewide discussion commenced to reexamine this issue.

BOE Legal Memo. On March 20, 2013, the BOE's Legal Department issued a memo reviewing the December 14, 2011 letter and an earlier annotated letter dated September 29, 2003, (former Property Tax Annotation 880.0155), and concluded that the certification could be made under certain circumstances, even when a PILOT agreement was in place.

BOE Town Hall Meeting. On November 6, 2013, the BOE held a [panel discussion](#) and some attendees noted the need to pursue legislative action. A video of the town hall meeting is available [online](#).

BOE Publishes New Annotation. On November 19, 2013, the BOE Members took [action](#) to publish a new Annotation [880.0155.005](#) based on the March 20, 2013 memo and deleted the prior annotated letter.

Property Tax Annotation 880.0155.005 now states:

RTC §214(g)(2)(B) requires a developer to certify that property tax savings be used to "maintain the affordability of" or "reduce rents otherwise necessary for" low-income housing units. A Payment In Lieu of Tax (PILOT) Agreement between a local government and an owner of a low-income housing project does not disqualify a developer from making the certification if rents have been

⁴ The bill also prohibits supplemental assessments imposed for the same reason in the case of a change in ownership or completion of new construction.

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maintained in accord with those required by section 214(g)(2)(A), and the developer has a reasonable belief that the PILOT payment will be used to support or benefit the low-income housing development.

Assembly Joint Informational Hearing. On February 3, 2014, the Assembly Committees on Housing and Community Development, Local Government, and Revenue and Taxation held a hearing entitled "Understanding the Scope of Payment in Lieu of Taxes (PILOTs) and Their Impact on the Welfare Property Tax Exemption." A video of the hearing and agenda is available [online](#) via the Cal Channel website.

Legislative Analyst's Office Report. The LAO issued a report for this hearing entitled "[Nonprofits and the Property Tax.](#)"

Partial Exemptions

§214

CURRENT LAW

Percentage of Value Calculation. Existing law allows the exemption to apply to rental housing that is not exclusively occupied by lower income households. The law provides that rental housing is "entitled to a partial exemption equal to that percentage of the value of the property that the portion of the property serving lower income households represents of the total property." While the law allows a partial exemption, it does not specify the method to calculate the "percentage of value." The BOE's administrative guidance to assessors on this issue is to calculate percentage of value by dividing the square footage of the exempt units by the total square footage of the structure.⁵ The guidance does not detail which square footage to include or exclude (i.e, living areas, common areas) in the calculation.

Related Facilities. The exemption applies to both rental housing and "related facilities." Current law does not define related facilities and does not expressly state how to treat common areas in a rental housing property where there is continual shared use by non-lower income households. Common areas include such areas as recreational facilities, rental office and community rooms, laundry rooms, interior/exterior walkways and halls, stairs, parking areas, and landscaped grounds.

PROPOSED LAW

Partial Exemption Calculation. These bills specify in law that partial exemptions will be calculated using a "number of units" basis. Specifically, rental housing and related facilities are entitled to a partial exemption "equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units." In plain terms, when 90 out of 100 residential units qualify, then the property and related facilities are entitled to a 90% exemption.

Related Facilities. These bills define related facilities for purposes of the low-income rental housing exemption. The definition for related facilities means:

- any manager's units
- any and all common area spaces that are included within the physical boundaries of the rental housing development, including, but not limited to, common area

⁵ The [Assessors' Handbook 267](#) on page 81 recommends that assessors use a square footage based method.

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space, walkways, balconies, patios, clubhouse space, meeting rooms, laundry facilities and parking areas.

Any portions of the overall development that are nonexempt commercial space are excluded from the related facilities definition. §214(g)(3)(B)

IN GENERAL

Under authority granted by the California Constitution, the Legislature has chosen to exempt from property taxation property used exclusively for religious, hospital, or charitable purposes. The exemption's main provisions, known as the "welfare exemption," are set forth in RTC Section 214(a), which enumerates many eligibility requirements.

In addition to the RTC Section 214(a) requirements, low-income housing projects must meet criteria set forth in RTC Section 214(g). Specifically, under RTC Section 214(g)(2)(B), the low-income housing property owner must certify that:

[T]he funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income individuals.

When claimants cannot make this certification, they may not receive a welfare exemption.

COMMENTS

1. **Sponsor and Purpose.** The purpose of these measures is to address in statute the issue of whether and how PILOT agreements impact a low-income housing project's ability to receive the welfare exemption. The measures also resolve the immediate concern facing low-income housing developments with existing PILOT agreements by creating a presumption that payments made under agreements created before January 1, 2015 support project affordability and allow these projects to continue receiving the welfare exemption. BOE Chairman Jerome Horton is sponsoring the provisions included in SB 1203 to allow refunds of taxes paid and cancellation of outstanding tax liability for those projects where the exemption was retroactively revoked, as well as the provisions to prevent exemption revocation on similarly situated projects elsewhere in the state. The authors are sponsoring the remaining provisions. The prohibition on new PILOT agreements between local governments and low-income housing projects owners is outside the BOE's purview and not discussed in this analysis. The provisions related to the partial exemption calculation and definition of related facilities is intended to promote uniformity and consistency in determining the exempt and taxable portions of low-income housing.
2. **Amendments.** The **August 2014 amendments** recast the contents of both bills. The amendments deleted all prior revisions to Section 214 related to PILOT agreements and instead place PILOT-related provisions into newly added law sections. Both bills must be enacted for either bill to become effective.
 - **Certification.** The recast provisions related to the property tax certification create a conclusive presumption as previously contained in AB 1760. Previously, SB 1203 proposed deleting the property owner's certification concerning use of property tax savings.
 - **Refunds, Cancellations, & Escapes.** The recast provisions continue to provide for refunds, cancellations, and prohibitions on future escape or supplemental assessments as previously contained in both bills.

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The new amendments to Section 214 relate to partial exemption issues. These amendments (1) define “related facilities,” (2) specify that the percentage of value calculation for the property and related facilities will be determined on a unit basis, and (3) include low-income units that are vacant in the count of units considered occupied by low-income households. Previously, SB 1203 added a definition of related facilities but did not address the partial exemption calculation method.

3. **PILOT issue simplified.** Low-income housing property may be exempt from property taxation under the welfare exemption. Since the local government will not receive its portion of property tax if the property is exempt, low-income housing developers or owners sometimes enter into agreements (often called PILOT agreements) to compensate local government for costs associated with the property. For property tax purposes, some concern exists regarding the effect of a PILOT on a low-income housing property’s eligibility for the Welfare Exemption.
4. **Financial implications of retroactively revoking a property tax exemption.** The low-income housing project owners are very concerned about the prospect of losing the welfare exemption for prior years in which they made PILOT payments. Since they did not anticipate such liabilities, they have insufficient funds to pay back taxes (escape assessments) and associated penalties.
5. **These bills will provide certainty regarding the PILOT issue.** The BOE, assessors, local governments, nonprofit organizations, and project financiers have an interest in clear and consistent treatment of properties subject to PILOT agreements when the welfare exemption eligibility is at stake. This bill cancels outstanding property tax liabilities on those projects where the welfare exemption was retroactively revoked due to a PILOT agreement and requires refunds for any payments already made. Furthermore, it prohibits other counties from revoking the exemption on other projects with pre-existing PILOTs in the future.
6. **These companion measures are double jointed and must both be enacted for either to be effective.** Both bills include identical findings and declarations and both prohibit PILOT agreements. The following table details the subject matter addressed by each bill.

Subject	RTC Section	Bill
Intent	Uncodified Findings and Declarations (Sec. 1)	AB 1760 & SB 1203
Partial Exemption Calculation	214	SB 1203
PILOT Prohibition	214.06	AB 1760 & SB 1203
PILOT Conclusive Presumption: Certification	214.07	AB 1760
Cancellations & Refunds; Escapes & Supplemental Prohibition	214.08	SB 1203

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Subject	RTC Section	Bill
PILOT definitions <ul style="list-style-type: none"> • Local government • Low-income housing project • Payment in lieu of taxes agreement 	214.09	AB 1760
No inference on PILOT authority pre-01/01/15.	214.06(b) & 214.07(b) 214.06(b) & 214.08(b)	AB 1760 SB 1203

7. **Certification regarding use of property tax savings.** The Senate Revenue and Taxation Committee analysis of AB 2144 (Stats. 1987, Ch. 1469) which added Section 214(g), and included the certification requirement from inception, noted the enforcement difficulty of this particular provision. The analysis stated: “[i]n order to claim the exemption the operator must demonstrate that the property tax saved goes toward furthering the low-income aspects of the project. It will be impossible, operationally, to make an unambiguous demonstration, or for the assessor, in most cases, to effectively challenge the demonstration. Enforcing this requirement will prove very difficult, and will cause much administrative difficulty both for the assessors and the assessee.”
8. **Conclusive presumption.** Section 214.07 creates a conclusive presumption that any payments made under any PILOT agreement entered into before January 1, 2015 are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households. The purpose of the presumption is to allow the low-income housing developer to make the necessary certification related to the use of property tax savings.
9. **This bill addresses an uncertainty that exists concerning the square footage used to calculate the percentage of value when providing a partial exemption.** The [BOE Assessors’ Handbook 267](#) page 81, advises assessors to use a square foot method to calculate the partial exemption percentage. The BOE advises assessors that the percentage of value is calculated by dividing the square footage of the “exempt units” by the “total square footage of the structure.” However, the Assessors’ Handbook doesn’t specify which areas fall within the category of “exempt units” for use in the numerator and which areas fall within the category of “total structure” for use in the denominator. As a result, the percentage of the exemption granted can vary.
10. **Specifying in statute that the partial exemption is calculated based on a percentage of affordable units promotes uniformity and simplicity.**
 - **County Uniformity.** Currently, counties do not uniformly calculate the partial exemption. Some counties already use a percentage of units basis. A per unit basis will eliminate the minor percentage differences that result from differing interpretations of which square footage to characterize as “exempt units” and “total structure.”
 - **Revenue and Taxation Code Conformity.** Partial exemptions would be calculated on the same basis for both low-income housing (§214(g)) and elderly and disabled housing (§214(f)). There is no compelling reason to have different

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calculation methods in statute depending on the housing type.

- **Simplicity.** The percentage of affordable units method is easier to understand and calculate and is less prone to mathematical errors.

11. Common areas historically have lacked uniform treatment. When a property also serves other than low-income households, concern has been expressed that commons areas, such as walkways and meeting rooms, either have not received the exemption or that when a partial exemption is applied, the amount provided is disputed. Questions have also been raised about whether it is appropriate to extend the exemption to certain facilities when low-income tenants pay fees for the amenity, such as covered parking. The definition of related facilities is intended to make clear that all areas listed are eligible for exemption, or partial exemption, as the case may be. The amount of the exemption is dependent on the number of units that qualify in the occupancy count.

12. The occupancy count. The number of units serving lower income households includes the following units:

- **All units occupied by lower income households.** Note that, as provided in [Property Tax Rule 140](#)(d)(2), any unit *actually used* for rental to lower income households at the qualifying rent qualifies for exemption. The exemption is not limited to the percentage designated for use by lower income households in the regulatory agreement, recorded deed restriction, or other legal document.
- **Manager's unit.** The manager's unit is listed in the new related facilities definition. (Property Tax Rule 140(d)(2) already extends the exemption to the manager's unit.)
- **Vacant reserved low-income units.** The sentence "[u]nits reserved for lower income households at an affordable rent that are temporarily vacant due to tenant turnover or repairs shall be counted as occupied" is intended to make clear that vacant units count towards the partial exemption calculation, provided the project operator is holding (i.e., reserving) the units for rental to low-income tenants only.

COST ESTIMATE

The BOE and counties co-administer the welfare exemption. The BOE would incur some minor absorbable costs to inform and advise county assessors, the public, and staff of the law changes, revise claim forms, and address ongoing implementation issues and questions. These costs are estimated to be under \$10,000.

REVENUE ESTIMATE

PILOT Program. Information on the number of PILOT agreements has proven difficult to obtain and is unknown, making it impossible to assess the full fiscal impact of these bills. To date, the identified property tax revenues at stake relate to four low-income housing projects that have received escape assessments for prior years' taxes related to PILOT agreements. Two projects have entered into five-year payment plans and have paid a total of \$450,000 toward outstanding liabilities of over \$6.1 million. In other projects where PILOT agreements became an issue, the city dropped the PILOT payment requirement to ensure the project would remain eligible for the property tax exemption. Thus, those properties do not impact this revenue estimate.

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Exemption eligibility status is uncertain regarding projects located in California, pending the outcome of this issue. The intent of these bills is to maintain eligibility for all projects currently receiving the exemption. These bills will cancel outstanding escape assessments of approximately \$5.65 million and refund \$450,000 in property taxes paid.

Partial Exemption. These provisions have a minimal revenue impact.

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